

**BOARD OF WATER SUPPLY
CITY AND COUNTY OF HONOLULU**

SINGLE AUDIT REPORTS

Fiscal Year Ended June 30, 2016

January 10, 2017

To the Board of Directors
Board of Water Supply
City and County of Honolulu

We have completed our audit of the basic financial statements of the Board of Water Supply (the "BWS"), a component unit of the City and County of Honolulu, as of and for the fiscal year ended June 30, 2016. Our report containing our opinion on those basic financial statements is included under a separate cover. We submit herein our reports on the BWS's internal control over financial reporting and compliance, compliance for each major federal program, internal control over compliance, and on the schedule of expenditures of federal awards.

OBJECTIVES OF THE AUDIT

The primary objectives of the audit were as follows:

1. To express an opinion as to whether your financial statements are fairly presented, in all material respects, in accordance with accounting principles generally accepted in the United States of America and to report on the fairness of the schedules of expenditures of federal awards, bonds payable and net revenue requirement when considered in relation to the financial statements as a whole.
2. To report on internal control over financial reporting and compliance with provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements in accordance with *Government Auditing Standards*.
3. To report on internal control related to major federal programs and an opinion on compliance with federal statutes, regulations, and the terms and conditions of federal awards that could have a direct and material effect on each major program in accordance with the Single Audit Act Amendments of 1996 and Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of the Uniform Guidance.

ORGANIZATION OF THE REPORT

This report is presented in five parts as follows:

- Part I - Our report on internal control over financial reporting and on compliance and other matters.
- Part II - Our report on compliance for each major federal program; report on internal control over compliance; and report on the schedule of expenditures of federal awards required by the Uniform Guidance.
- Part III - The schedule of findings and questioned costs.
- Part IV - The corrective action plan.
- Part V - The summary schedule of prior audit findings.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the staff of the BWS.

Sincerely,

N&K CPAs, INC.

BOARD OF WATER SUPPLY

TABLE OF CONTENTS

	<u>Page</u>
PART I REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	6 - 7
PART II REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE	
Report on Compliance for Each Major Federal Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance	9 - 11
Schedule of Expenditures of Federal Awards	12
Notes to Schedule of Expenditures of Federal Awards	13
PART III SCHEDULE OF FINDINGS AND QUESTIONED COSTS	15
PART IV CORRECTIVE ACTION PLAN	19 - 20
PART V SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS	
Status Report	22

PART I

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

**REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Board of Water Supply
City and County of Honolulu

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Board of Water Supply (the "BWS"), a component unit of the City and County of Honolulu, as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, and have issued our report thereon dated December 20, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the BWS's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the BWS's internal control. Accordingly, we do not express an opinion on the effectiveness of the BWS's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as item 2016-001 that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the BWS's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

BWS's Response to Findings

The BWS's response to the findings identified in our audit in the accompanying corrective action plan. The BWS's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

N + K CPAs, INC.

Honolulu, Hawai'i
December 20, 2016

PART II

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL
PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND
REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
REQUIRED BY THE UNIFORM GUIDANCE**

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM;
REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND
REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL
AWARDS REQUIRED BY THE UNIFORM GUIDANCE**

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Board of Water Supply
City and County of Honolulu

Report on Compliance for Each Major Federal Program

We have audited the Board of Water Supply's (the "BWS") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the BWS's major federal programs for the fiscal year ended June 30, 2016. The BWS's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the BWS's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements

referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the BWS's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the BWS's compliance.

Opinion on Each Major Federal Program

In our opinion, the BWS, complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2016.

Report on Internal Control over Compliance

Management of the BWS is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the BWS's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the BWS's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the BWS, as of and for the fiscal year ended June 30, 2016, and have issued our report thereon dated December 20, 2016, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. We have not performed any procedures with respect to the audited financial statements subsequent to December 20, 2016. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

N + K CPAs, INC.

Honolulu, Hawai'i
January 10, 2017

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016**

Federal Grantor/Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Total Federal Expenditures
U.S. ENVIRONMENTAL PROTECTION AGENCY			
Pass-through Department of Health, State of Hawai'i			
Capitalization Grants for Drinking Water State			
Revolving Funds	66.468	ASO LOG #15-079	\$ 2,352,973
	66.468	ASO LOG #14-196	2,294,057
	66.468	ASO LOG #15-059	1,267,053
	66.468	ASO LOG #16-105	1,070,149
	66.468	ASO LOG #14-195	712,707
	66.468	ASO LOG #13-123	419,707
	66.468	ASO LOG #06-170	<u>143,879</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ <u>8,260,525</u>

The accompanying notes are an integral part of this schedule.

**Board of Water Supply
City and County of Honolulu
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2016**

NOTE A - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal award activity of the BWS under programs of the federal government for the fiscal year ended June 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the BWS, it is not intended to, and does not, present the financial position, changes in net position, or cash flows of the BWS.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

The BWS has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

PART III
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2016**

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP:

Unmodified

Internal control over financial reporting:

Material weakness(es) identified?

☒ yes

☐ no

Significant deficiency(ies) identified?

☐ yes

☒ none reported

Noncompliance material to financial statements noted?

☐ yes

☒ no

Federal Awards

Internal control over major federal programs:

Material weakness(es) identified?

☐ yes

☒ no

Significant deficiency(ies) identified?

☐ yes

☒ none reported

Type of auditor's report issued on compliance for major federal programs:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?

☐ yes

☒ no

Identification of major federal programs:

CFDA Number

Name of Federal Program or Cluster

66.468

Capitalization Grants for Drinking
Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs:

\$750,000

Auditee qualified as a low-risk auditee?

☒ yes

☐ no

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016**

SECTION II - FINANCIAL STATEMENT FINDINGS

Ref. No.

2016-001 Improve Internal Controls over Accounting for Significant Nonroutine Transactions

Criteria:

Accounting for nonroutine transactions may require the application of accounting principles that an entity's personnel may not be familiar with. Management should proactively identify these types of transactions and determine the proper accounting treatment in accordance with accounting principles generally accepted in the United States of America (GAAP). Management should also be actively involved in the timely review of the nonroutine transactions that are posted to the entity's accounting system to ensure that the transactions are properly recorded.

Condition:

The 2015 financial statements of the BWS were restated to correct errors in the accounting for the deferred loss on refunding of debt and state revolving fund notes payable. The misstatement of the deferred loss on refunding was the result of amortizing the loss over a period shorter than the period required by GAAP. The misstatement of notes payable was due to the inclusion of the principal portion of the obligation that had been forgiven as of June 30, 2015. The resulting effect on the change in net position for the fiscal year ended June 30, 2015 was an increase of \$6,611,890 from the previously reported amount.

Cause:

Both errors involved accounting for significant transactions occurring during the fiscal year ended June 30, 2015 that were outside the normal course of business for the BWS: 1) the issuance of the Series 2014A and 2014B water system revenue bonds and certain state revolving loans that were used to advance refund a portion of previously issued bonds and, 2) the receipt of state revolving fund loan proceeds under a loan agreement that contained a principal forgiveness clause.

Effect:

Because of the infrequent nature of significant, nonroutine transactions, they are inherently more susceptible to material misstatement than routine transactions that an entity's personnel are accustomed to accounting for. As a result, these type of transactions have a significantly higher risk of a material error occurring.

**Board of Water Supply
City and County of Honolulu
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2016**

SECTION II - FINANCIAL STATEMENT FINDINGS (Continued)

Ref. No.

2016-001 Improve Internal Controls over Accounting for Significant Nonroutine Transactions (Continued)

Recommendation:

Management should proactively identify significant, nonroutine accounting transactions and ensure that a process is established whereby management-level fiscal personnel are actively involved in both the determination of the proper accounting treatment and the timely review of the transactions posted to the BWS's accounting system.

View of Responsible Officials and Planned Corrective Action:

Management agrees with the finding and recommendation. See Corrective Action Plan on page 20.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters reported

PART IV
CORRECTIVE ACTION PLAN

BOARD OF WATER SUPPLY

CITY AND COUNTY OF HONOLULU
630 SOUTH BERETANIA STREET
HONOLULU, HI 96843



January 10, 2017

KIRK CALDWELL, MAYOR

BRYAN P. ANDAYA, Chair
ADAM C. WONG, Vice Chair
DAVID C. HULIHEE
KAPUA SPROAT
KAY C. MATSUI

ROSS S. SASAMURA, Ex-Officio
FORD N. FUCHIGAMI, Ex-Officio

ERNEST Y. W. LAU, P.E.
Manager and Chief Engineer

ELLEN E. KITAMURA, P.E.
Deputy Manager and Chief Engineer *ek*

Chair and Members
Board of Water Supply
City and County of Honolulu
Honolulu, Hawaii 96843

N&K CPAs, Inc.
Attention: Mr. Ryan Iwane
American Savings Bank Tower
1001 Bishop Street, Suite 1700
Honolulu, Hawaii 96813

Subject: Internal Controls Review on the Financial Statement Audit for the Year Ended June 30, 2016

The Honolulu Board of Water Supply (BWS) has reviewed the internal controls audit finding that you submitted. Subsequent to this review, the BWS has taken steps to address the recommendations stated therein via the attached detailed Corrective Action Plan.

As with any audit, management welcomes the comments and recommendation of the auditor that will assist us in becoming more efficient and effective in serving our customers and community.

We look forward to working with you and your staff during the current year to gain a stronger understanding of the audit process and clarity of audit documentation requirements along with your continued assistance in the development and implementation of our corrective action plan to appropriately address the audit findings, concerns, and recommendations.

Very truly yours,

ERNEST Y. W. LAU, P.E.
Manager and Chief Engineer

Attachment

BOARD OF WATER SUPPLY

CITY AND COUNTY OF HONOLULU
630 SOUTH BERETANIA STREET
HONOLULU, HI 96843



KIRK CALDWELL, MAYOR

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Deputy Manager and Chief Engineer

Corrective Action Plan January 10, 2017

As noted in the Board of Water Supply, City and County of Honolulu, Single Audit of Federal Financial Assistance Programs June 30, 2016, Schedule of Findings and Questioned Costs, Fiscal Year Ended June 30, 2016, identified in Finding No. 2016-001 was the following significant deficiency.

The following will serve as a formal response to the recommendation noted in the Schedule of Findings and Questioned Costs, Year Ended June 30, 2016.

Improve Internal Controls over Accounting for Significant Non-routine Transactions

Recommendation:

Management should proactively identify significant non-routine accounting transactions and ensure that a process is established whereby management-level fiscal personnel are actively involved in both the determination of the proper accounting treatment and the timely review of the transactions posted to the BWS's accounting system.

View of Responsible Officials:

Management agrees with the finding and recommendation.

Corrective Action: Complete by December 31, 2016

The Finance Division has competent, experienced staff who stay current with governmental accounting and financial reporting standards, as well as industry practices. Regular meetings are held between the senior finance staff and the Finance Division management to allow for the exchange of relevant financial and operational information. Our internal controls will be strengthened by developing a formal agenda with recurring topics that focus on non-routine transactions, new accounting pronouncements, financial risk, and other current issues. The Finance Division management will track the status of these issues and assure that these issues are addressed, adequately documented, and reflected in the financial statements.

Responsible Person: Joe Cooper, Waterworks Controller

PART V

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**Board of Water Supply
City and County of Honolulu
STATUS REPORT
Fiscal Year Ended June 30, 2016**

No prior audit findings which apply under the current criteria of the Uniform Guidance were noted.